

ICELAND

UNITARY COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: HIGH INCOME

LOCAL CURRENCY: ICELANDIC KRÓNA (ISK)

POPULATION AND GEOGRAPHY

Area: 100 243 km²**Population:** 0.343 million inhabitants (2017), an increase of 0.6% per year (2010-2015)**Density:** 3 inhabitants / km²**Urban population:** 93.8% of national population**Urban population growth:** 1.8% (2017 vs 2016)**Capital city:** Reykjavik (63% of national population)

ECONOMIC DATA

GDP: 18.1 billion (current PPP international dollars), i.e. 52 825 dollars per inhabitant (2017)**Real GDP growth:** 3.6% (2017 vs 2016)**Unemployment rate:** 2.7% (2017)**Foreign direct investment, net inflows (FDI):** - 7 017 (BoP, current USD millions, 2017)**Gross Fixed Capital Formation (GFCF):** 22.1% of GDP (2017)**HDI:** 0.935 (very high), rank 6

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

Iceland is a constitutional republic with a parliamentary system. According to the 1944 Political Constitution, the Head of State is the President, elected by direct popular vote for four-year terms, and the government is led by the Prime Minister, appointed by the President with the support of the Parliament. The legislative power is vested in the unicameral Parliament (*Althingi*) which is the oldest Parliament in the world (it has existed since 930 a.d.) and whose 63 members are directly elected for four-year terms. The President is also vested with legislative power in the sense that he is empowered to sign bills into law, has veto power, and may send bills to the Parliament.

Iceland is a unitary country with a single-tier of subnational governments, made up of municipalities. Article 78 of the 1944 Constitution forms the basis of the legal status of local authorities and their relationship with the central government. Alongside the Constitution, local autonomy is enshrined in the Local Government Act of 1998, amended several times in particular in 2011. Other specific regulations are the Local Government Elections Act (5/1998), and the Local Government Finance Act (4/1995).

The municipalities are governed by municipal councils, named according to their size (city government, town government and parish councils) that are directly elected every four years. Local councils are composed of aldermen whose number varies depending on the population and are headed by a president (*oddviti* or *forseti* depending on the size of the municipality) elected by municipal council majority. The executive committee is the municipality's executive body and is composed of municipal council members designated by the council. It is in charge of the financial and administrative management of the municipality. Following elections, the municipal council may decide to appoint one of its members as mayor or may designate a non-political person to take on this role.

Through the 2011 revision of the Local Government Act, municipalities gained new responsibilities regarding service provision and support for disabled people. The law established new fiscal rules for municipalities together with enhanced arrangements for fiscal oversight of municipal finances and greater fiscal stability and new fora for central-local fiscal coordination. Other transfers are currently being discussed (e.g. elderly care, entire healthcare sector) but the main obstacle is the small size of many municipalities.

TERRITORIAL ORGANISATION

2018	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	74 municipalities (<i>sveitarfelag</i>)			
	Average municipal size: 4 640 inhabitants			
	74			74

OVERALL DESCRIPTION. Iceland has a single tier of local government, made up of municipalities. Municipalities in Iceland date back to the 11th century. Following gradual mergers, the number of local authorities increased slowly until the middle of the 20th century when it reached a peak of 229, after which it decreased again, falling from 124 in 2000 to 74 as of January 2018. Municipalities had to negotiate the merger plans between themselves, to be approved by local referendums. There has been two main waves through two comprehensive local referendums on municipal amalgamations, first time in 185 municipalities in 1993 and the second time in 66 municipalities in 2005. The main objective is to reach a minimum size to be able to provide efficient and high-quality services.

Despite the magnitude of the amalgamation process, it did not have a major impact on municipal fragmentation, which remains high, especially as the population in certain municipalities dwindles. As of 2017, the average size of municipalities is around 4 600 inhabitants while the median size is 880 inhabitants. Around 88% of municipalities have fewer than 5 000 inhabitants and 72% less than 2 000 inhabitants. Only six municipalities have more than 10 000 inhabitants, including the three largest municipalities: Hafnarfjörður (around 28 700 inhabitants), Kópavogur (35 250) and Reykjavík (123 246). These three municipalities, together with other five neighbouring municipalities, form the Greater Reykjavík ("The Capital Region"), accounting for 63% of national population. Municipalities in the urban area created an association in 1976 to cooperate in various fields such as waste policy, public transport and fire protection as well as defining the regional development programme.

An evaluation of merger policy conducted in 2010 shifted focus from mergers and recommended to promote inter-municipal cooperation instead, considering that cost-efficiency, economies of scale and capacity could be gained by inter-municipal service or cooperation arrangements. Inter-municipal cooperation takes place on a regional basis through regional boards, regional federations, or economic development agencies that are co-owned by the municipalities (Local Government Act no. 45/1998). Following the decentralisation of social services for disabled people to municipalities, inter-municipal cooperation became compulsory for municipalities of fewer than 8 000 inhabitants. In total, 197 formal cooperation arrangements exist throughout the country and the average involvement of a municipality in a cooperation arrangement is 13.5, however varying significantly by region and municipality (6–23). By far the most frequent areas of cooperation are primary school and various social services.

There is no regional government, but instead six regional associations of municipalities, based on regional cooperation between local governments. They also serve as a central government deconcentrated body. These regional associations are in charge of preparing and implementing regional development plans for their regions, in line with the Iceland 2020 – Governmental policy statement for the economy and community, which provides guidance. This national strategy emphasises the need to strengthen municipalities, and proposes to grant a special status to Reykjavik City and the whole capital area. In some cases, the regional associations have also been entrusted with special tasks from municipalities (e.g. waste collection and management of school offices).

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

Municipalities' competences are not provided by a single Act, but rather by several sectorial laws. All municipalities have the same competences regardless of their size (principle of uniformity). Compulsory tasks are entrusted to them by law (Article 7.1 of the Local Government Act), which cover mainly education, urban planning and environment, and social welfare.

In addition to these assigned responsibilities, municipalities can also undertake additional tasks in the interests of their communities, provided that these tasks are not assigned to others by law, as enacted in the general residual provision (general competences, Art. 7.3) and provided that they have the budget to support these functions.

The role of local authorities became more important and comprehensive in 1996, when they embraced primary schools and social services. Since 2011, the municipalities have also taken over all services for disabled people. With this new competence, came the requirement to have a population threshold of at least 8 000 inhabitants. Only six municipalities are administering this task by themselves whereas others are running it through inter-municipal cooperation projects (*byggðasamlög*) which may cover up to 13 municipalities.

Moreover, local governments own almost all of the geothermal power companies, which supply heating to most homes in Iceland and, on an increasing scale, provide electricity to the aluminium industry. Several local governments also own companies that manage harbours.

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

MUNICIPAL LEVEL	
1. General public services	Internal administration; Issuing various licences for business; Building permits
2. Public order and safety	Fire services
3. Economic affairs/transport	Street/road construction and maintenance; Public transport; Economic promotion and employment; Harbours
4. Environmental protection	Waste collection and treatment; Wastewater; Environment protection; Public parks and open areas
5. Housing and community amenities	Water supply; Electricity; District heating; Town planning and building regulation; Social housing
6. Health	Monitoring of public and environmental health; Primary health services for the elderly
7. Recreation, culture & religion	Culture; Sports; Youth; Leisure; Public libraries; Museums
8. Education	Pre-schools; Primary and lower secondary schools; After school and summer holiday arrangements for children
9. Social protection	Care for disabled persons; Supplementary assistance to general pensions and income support programmes; Welfare services for the elderly; Child welfare; Youth support

SUBNATIONAL GOVERNMENT FINANCE

Scope of fiscal data: municipalities, nursery schools, primary schools and senior residential institutions, as well as the Municipal Equalisation Fund.	SNA 2008	Availability of fiscal data: High	Quality/reliability of fiscal data : High
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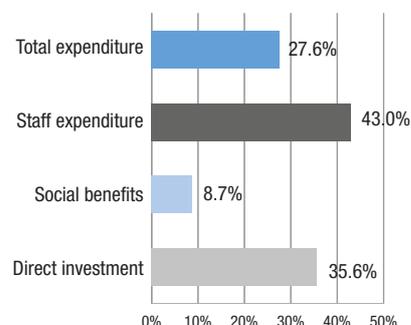
GENERAL INTRODUCTION. Provisions regarding local finance come from the Local Government Act (art. 3) and the Local Government Finance Act (Law 4 of 1995). Icelandic municipalities enjoy a significant degree of financial autonomy; however, their spending and revenue capacities are limited by the small size of most local authorities. The country was severely hit by the 2008 global financial crisis because of the bankruptcy of the banking system which had a significant role in the national economy. It triggered a major economic downturn with high unemployment and inflation. The government had to turn to the International Monetary Fund (IMF) for a bailout. This economic crisis severely disrupted its public finances, and led to an increase in local government debt. The recent growth of the tourism sector created new opportunities for revitalising regional economies, but it also presents a new challenge to municipalities that lack the capacity and resources to provide the necessary services and infrastructure.

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SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2016	DOLLARS PPP / INH.	% GDP	% SNG EXPENDITURE	% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)
Total expenditure	6 340	12.5%	100%	
Incl. current expenditure	5 787	11.4%	91.3%	
Staff expenditure	2 949	5.8%	46.5%	
Intermediate consumption	1 998	3.9%	31.5%	
Social expenditure	266	0.5%	4.2%	
Subsidies and current transfers	332	0.7%	5.2%	
Financial charges	242	0.5%	3.8%	
Others	0	0.0%	0.0%	
Incl. capital expenditure	553	1.1%	8.7%	
Capital transfers	54	0.1%	0.9%	
Direct investment (or GFCF)	499	1.0%	7.9%	

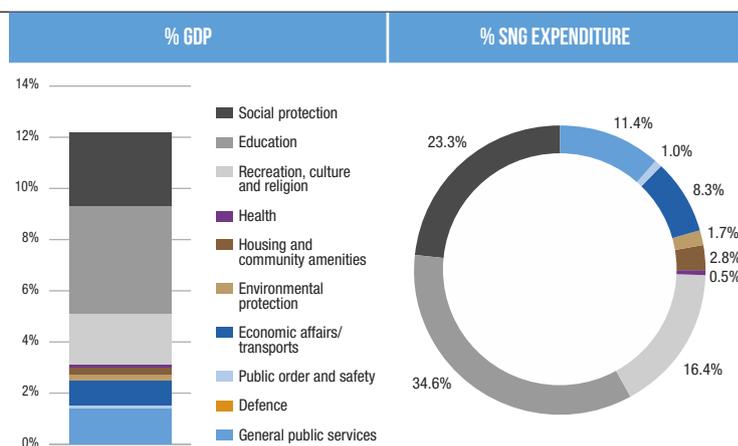


EXPENDITURE. The level of local expenditure in GDP and total public spending in Iceland is below the OECD average amounting to 16.2% of GDP and 40.4% of public spending in 2016. Icelandic local authorities are one of the biggest employers in the country. The share of staff expenditure in SNG expenditure is above the OECD average (36%) but SNG staff spending in public staff spending is below the OECD average (62.9%) but with the average for OECD unitary countries (43.0%). Administrative costs tend to weigh more on the smallest municipalities due to the prevalence of small municipalities. Overall, current expenditure accounted for around 91% of SNG expenditure in 2016.

DIRECT INVESTMENT. During the pre-crisis years, many municipalities had been investing in infrastructure as a way to attract new companies and inhabitants. After the crisis, direct investment at the national and local level slumped, and as of 2016 the share of SNG in total public investment remained below the OECD average (35.6% in Iceland versus 56.9% in the OECD). Between 2008 and 2016, SNG investment decreased by 9% per year in real terms. The 2011 fiscal rules and caps on municipalities' debt levels further restrained investments. Investment levels started to recover at the national level in 2015, mainly in the transport sector. Besides, the rise of tourism in the country incurred rising spending pressures, in particular regarding the upgrade and expansion of infrastructure, creating particular difficulties for local governments. Local governments can undertake development projects in combination with the Icelandic Regional Development Institute in the tourism sector.

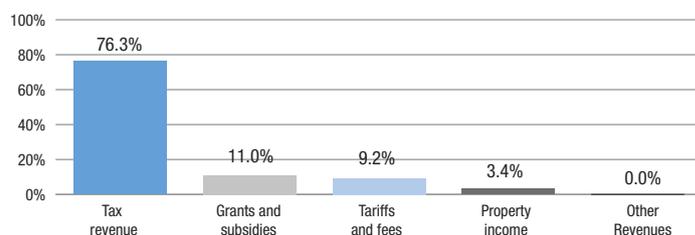
SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

Local authorities' spending in Iceland is particularly concentrated in the fields of education, social protection and recreation, culture and religion, which overall constitute 74% of SNG spending. The largest area of local spending is education, whose shares in SNG spending and GDP is higher than the average for OECD countries (24.8%). Municipalities are responsible for both current and capital expenditure, including teacher salaries, from pre-schools until lower secondary education, while the central government runs upper secondary schools and universities. Social welfare is also an important spending category, which represents a larger share than in the OECD countries (14.0%), since SNGs have been devolved functions relative to the care of the disabled, and are responsible for a part of general pensions schemes and income support programmes (for instance, for people whose unemployment benefits expire). Besides, municipalities' expenditure in housing and community amenities and recreation and culture account for 71.9% and 65.5% of general government expenditure (respectively). On the other hand, local authorities play a very minor role in the health sector, which remains a centralised function.



SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2016	DOLLARS PPP / INH.	% GDP	% GENERAL GOVERNMENT REVENUE (SAME REVENUE CATEGORY)	% SNG REVENUE
Total revenue	6 379	12.6%	21.7%	
Tax revenue	4 869	9.6%	19.9%	
Grants and subsidies	701	1.4%		
Tariffs and fees	589	1.2%		
Property income	219	0.4%		
Other revenues	0	0.0%		



OVERALL DESCRIPTION. Iceland has the highest share of tax revenues in SNG revenue among all OECD countries, the OECD average being 44.6%. Consequently, Iceland also has the lowest share of intergovernmental transfers (11.0% vs 37.2% in the OECD on average). While tariffs and fees accounted for a small portion of SNG revenues compared to the OECD average (14.9%), the level of property income is particularly high (3.4% vs 2.0% in the OECD). Nevertheless, SNG revenue, which accounts for 12.6% of the GDP and 21.7% of public revenue, remains below the OECD average (respectively 15.9% and 42.4%).

TAX REVENUE. There is no tax sharing arrangements in Iceland and all municipal tax revenues come from own-source taxation. They derive primarily from the municipal personal income tax (PIT), which represented 81.2% of municipal tax revenue in 2016, i.e. 62% of total municipal revenue and 7.8% of GDP. The PIT is levied by both the central and local governments, the latter receiving a little more than half of total PIT receipts. The municipal share of the PIT corresponds to a flat percentage of total taxable income, which varies slightly across municipalities. This rate can vary between 12.44% and 14.52% (Art. 23 of the Law 4/1995), and was set on average at 14.45% in 2016.

The second source of local tax revenue is the property tax on residential and commercial buildings, which represented 18% of SNG tax revenue and 13.6% of SNG total revenue in 2016. The tax rate varies (up to 1.65%), depending on the municipality and the type of property (Art. 3, Law 4/1995). The property tax rate for residential housing (A-tax) is limited by the central government at 0.5%, and that on commercial premises (C-tax) at 1.32%. Local authorities are authorised to levy a special A and C tax of 25%. From 2006 to present, government buildings like schools and hospitals pay a rate of 1.32% for the property tax (B-tax). Overall, the property tax amounted to 1.7% of GDP, well above the OECD average (1.1% in 2016). There is also several small taxes on the use of goods and provision of services activities that account for 2% of the SNGs tax revenues.

GRANTS AND SUBSIDIES. Transfers mostly come from the Municipal Equalization Fund, established in 1937 and regulated by the Law 4 of 1995. This Fund has gradually expanded in the 1990s and more recently when SNGs took on greater spending responsibilities regarding elementary schools and care for persons with a disability. The main role of the Equalisation Fund is to equalise municipal tax revenue so they can all provide services to their inhabitants. The central government contributes to the Fund through an annual contribution corresponding to 2.12% of its total tax revenues and 0.264% of the previous year's PIT base. Local governments also contribute 0.77% of their PIT base (earmarked for elementary school expenditure) and 0.95% of the PIT base (earmarked for disabled expenditure). Fund revenues are then shared among the municipalities based on a complex formula that takes municipal expenditure and resources into account. The Fund is managed by the Minister of the Interior, assisted by a seven-member advisory committee appointed for a period of four years by the Association of Local Authorities and the Minister of the Interior. Recent discussions tended to promote a reform of the Icelandic equalisation scheme in order to promote further mergers and inter-municipal cooperation across municipalities, to enhance the efficiency of local policies. In 2016, 88.7% of grants were current grants, while 11.3% were capital grants.

OTHER REVENUES. SNGs have considerable autonomy in setting local fees and charges. They have their own business operations and institutions responsible for providing public services, such as water, electricity and heating utilities. Additionally, they receive revenue from sewage disposal fees, rental fees, license fees. A new parking fee to be levied outside urban areas was recently introduced to match increased expenditures for municipalities. However, the level of user charges and fees is below the OECD average. Property income includes revenues from rents and sales of assets as well as revenues from local public companies (dividends). It accounted for 3.4% of their revenue, above the OECD average of 2.0%. In the aftermath of the 2008 banking crisis, a small group of municipalities sold all their properties, such as school buildings, and rent them back through contracts.

■ SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

2016	DOLLARS PPP/INH.	% GDP	% GENERAL GOVERNMENT DEBT	% SNG DEBT
Total outstanding debt	10 322	15.9%	17.3%	100%
Financial debt*	6 715	10.4%	18.3%	65.1%

* Currency and deposits, loans and bonds

FISCAL RULES. In 2011 the new Local Government Act 138/2011 introduced a budget and debt rule. For current operations, it obliges municipalities to balance their revenue and expenditure over a three-year period. Since 2011, local governments are also monitored by an independent external body, the Municipal Fiscal Oversight Committee (MFOC), which classify them into one of three categories depending on their compliance with these fiscal rules. Municipalities that do not comply with the rules may be sanctioned, its fiscal powers may be suspended by the Minister of Local Governments and vested in a financial management board. The new law on public finance (Public Finance Act, Law 123/2015, 28 December 2015) also includes relevant provisions for local government. It provides - for the first time - new rules on fiscal strategy, including both the State and the municipalities, based on a "Fiscal Strategy Plan".

DEBT. As a result of the investments made in the pre-crisis years, many municipalities had important amounts of debt denominated in foreign currencies that were indexed to inflation. When the *króna* collapsed in 2008, local debt exploded, burdening them financially. The SNG debt-ratio has increased 3 percentage points since 2013 (from 12.8% to 15.9%), and the share of the local debt in the total public debt also increased from 11.4% in 2013 to 17.3% in 2016. Still, fiscal policy has made significant progress in reducing the public debt. In 2001, the Local Government Act also introduced a debt rule, limiting total SNG debt and liabilities to 150% of total revenue. Local governments above the limit are required to bring the debt ratio under this benchmark within a period of ten years. Local governments with total debt exceeding 250% of revenue are prohibited from raising new debt except for refinancing. In 2016, the local debt level was below the OECD average both regarding the share of GDP (24.5%) and public debt (20.7%). Total outstanding debt is composed of financial debt (65%), insurance pensions (21%) and other accounts payable (14%). Financial debt comprises loans for 64% of debt stock and bonds (23%). The Municipality Credit Iceland (MCI) is a capital loan fund owned by the local authorities, providing between 25% and 30% of the financing needs of Iceland's municipalities.



Lead responsible: OECD
Last update: 02/2019

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Socio-economic indicators: OECD // World Bank // UNDP // UN Desa // ILO // Statistics Iceland.

Fiscal data: OECD National Accounts Statistics // OECD Revenue Statistics // OECD (2018) Subnational Government in OECD countries: key data (brochure and database) // Statistics Iceland.

Other sources of information: OECD (2018) Regions and cities at a Glance // Icelandic Association of Local Authorities (2017) Local Government in Iceland // OECD (2017) OECD Economic Surveys: Iceland 2017 // Council of Europe (2017) Local democracy in Iceland – CLRA CPL32(2017)06final // Grétar Thór Eythórssón (2017) Inter-municipal cooperation: Democratic concerns, accountability and efficiency. The case of Iceland // Central Bank of Iceland (2016) Economy of Iceland, Public Sector // CEMR (2016) Local and Regional Governments in Europe Structures and Competences // European Committee of Regions (2016) Division of Powers // OECD (2015) "Iceland", in The State of Public Finances 2015: Strategies for Budgetary Consolidation and Reform in OECD Countries // Sverrisson, S., Hanesson, & Karel, M. (2014) Local Governments in Iceland. // Snaevarr, S. (2010) Responsibility for local government finance in Iceland. Workshop on Local Authorities' Fiscal Rules and Finances.